



Munich Personal RePEc Archive

Pins in the shoes of microfinance

S. Badruddoza

Institute of Microfinance (InM), Dhaka, Bangladesh

9. April 2012

Online at <https://mpra.ub.uni-muenchen.de/37944/>

MPRA Paper No. 37944, posted 9. April 2012 13:59 UTC

Pins in the Shoes of Microfinance

S. Badruddoza¹

Abstract

This note critically discusses the possible endogenous problems that microfinance sector in Bangladesh should seriously take into account. It also draws possible explanations and/or consequences of these factors. The broad understanding is that the sector should emphasize credit plus programs, skill development of borrowers, strong monitoring, product diversification, microenterprise for graduated members and micro-insurance to withstand shocks. For extreme poor, safety-net programs are better option than microfinance.

People who support microfinance show numerous points where microfinance has succeeded. To say the least, microfinance has positive impact on women empowerment, consumption smoothing, and to some extent, in building assets. [See, for example, Hossain 2002; Rahman & Khandker 1994; Zaman 1999; Pitt & Khandker 1998; Khandker 2000; Schuler, Hashemi & Riley 1997; Sharif 2001] However, one of the most important successes of microfinance programs in Bangladesh was to provide the poor (around 7 out of 10 people) with access to financial services [Khalily et. al. 2012; Matin 2002].

To anti-microfinance party, microfinance seems to be anti-poor, although it was supposed to be pro-poor, because it does not help them go out of poverty. Moreover, it leads to over-indebtedness. Thus the poor demotion to ultra-poor and some of them even commit suicide. Political leaders and media have immensely focused on the failures of microfinance in recent times. [See Roodman & Morduch 2009, Ahmad 2007, Morduch 1998, Ashta, Khan & Otto 2011; Melik 2010; Roodman 2011]

¹ Research Associate at the Institute of Microfinance (InM), Dhaka, and can be reached at badruddoza@inm.org.bd

There are, of course, exogenous factors contributing to this failure, such as poor infrastructure, vulnerability to various shocks and insecurity (these jeopardize business environment for microcredit borrowers), most of them are in ‘macro’ sense; but we shall be concentrating here on endogenous factors only; which are closer to ‘micro’ perspective. For instance, lack of skilled person is a problem that can be solved by microcredit programs assessing borrower level capability—a microeconomic case. Let us portray every single case that can happen in microfinance operation and find out the pins in the shoes of microfinance. We shall underline the key terms onwards that matter most.

Poor people take credit and they invest it as well. Nonetheless, since they do not have essential skill, they fail to generate sufficient returns to repay the loan. The problem in business environment, as mentioned earlier, is exogenous and is another impediment for the generation of sufficient revenue. So a “credit-plus” approach is needed for skill development, basically to support the credit program *per se*.

The poor take credit and they invest it on some “not mentioned at the time of receiving loan” type businesses; which is called “diversion of credit use” in technical term. This is not a problem, if they can timely repay. However, it can change the desired outcome of a programmed intervention. Moreover, if they fail to repay, then strong monitoring is needed by microfinance institutions. For this, microfinance institutions have to pay their credit staff sufficient compensation; which might not make their balance sheets better. In some cases, microfinance institutions resolve this issue linking salaries with performance of their credit staff.

Poor people may engage in diversion of credit use just because the “stated” use of credit will not generate sufficient returns to repay the loan within the “stipulated time” of credit use. Sometimes they prefer migration to credit due to the strict repayment schedule. [See Hashemi 1997; Rahman & Hossain 1991; Sonchay 2008; Karlan & Mullainathan 2009]

Sometimes, people need more money than a single membership of a particular microfinance institution can offer. Therefore, they borrow from multiple microfinance institutions and the overlapping borrowings may lead to over-indebtedness [Khalily et. al. 2011]. Microfinance institutions can offer microenterprise loans for the clients who need higher amount of money.

Some very poor people take credit and that only increases their consumption because it is their primary need [Khandker et. al. 2010; Khalily et. al. 2010a; Khalily et. al. 2010b; Rabbani et. al. 2011],

and thus they fail to repay; or they do repay, but borrowing from some other sources. This also leads to multiple memberships and overlapping of borrowings. The problem, if solvable, must be through some safety-net program, or some “low or no interest” credit programs. [Zaman 1999; Khandker & Mahmud 2010]

In some cases, poor people are bound to use the credit in consumption due to some shocks. A micro-insurance scheme along with credit would help them come out of the shock. [Ahsan 2010]

Want is always unlimited and money is the most liquid and fungible asset. So the marginal utility of money is hardly decreasing. The axiom explains the sustained rate of interest in microcredit for about three decades despite of the fact that several thousand microfinance institutions have joined the market during this period. So both the demand and supply schedule of credit intersect at a similar price, i.e. the interest rate, and poor people neither can understand the calculations well, nor do they get opportunity to use loan for the entire time period stated [Faruquee 2011; Khandker & Badruddoza 2012].

So observing the high demand for credit, increasing number of microfinance institutions are entering the market, increasing the competition and the probability of multiple borrowings as well [Alamgir 2010; Iqbal 2010]. Nevertheless, not all of them found a desired position. Major three microfinance institutions that started earlier: Grameen Bank, BRAC and ASA are still occupying more than three-fourth of the market [Sinha 2011]. Grameen has its huge coverage and thereby it can finance the credit from the huge savings generated. BRAC has various credit-plus program and enviable collection of fixed asset. ASA focuses mainly on credit and it has achieved the operating efficiency better than any other microfinance institution [Faruquee & Badruddoza 2011].

These three role models indicate that any new microfinance institution should maintain high coverage, cost efficiency, high fixed asset and credit plus programs. Microfinance institutions mainly depend on members’ savings, subsidized funds and bank loans. If they use bank loans to finance their credit programs, they will end up with high interest rate. If they use subsidized funds, they will not be sustainable. The possible way-out is member savings, for which they should substantially increase product diversity and outreach.

If some microfinance institutions do not have the power of savings and good coverage, there are two polar options: first, to have subsidized funds and help people with low-interest credit and other

social welfare program, which is difficult to maintain. Second, they have to borrow from commercial banks and reinvest it into microfinance program. The later one is commercialization of microcredit, which makes the process sustainable, but not desirable [Charitonenko & Rahman 2002].

Some needy people do not want to take credit at all. Either because of some or all aforementioned negative sides, or they do not have pro-credit personal values. Non-poor people take credit, sometimes, using poor people's accounts if the credit is provided at a subsidized rate. Again, this is not a problem unless they refuse to repay. However, it might change the results of targeted microfinance interventions.

So the broad understanding here is that the microfinance sector of Bangladesh should emphasize credit plus programs, skill development of borrowers, strong monitoring, product diversification, microenterprise for graduated members and micro-insurance to withstand shocks. For extreme poor, safety-net programs are better alternative than microfinance. Success in resolving these issues will automatically bring sustainability to the microfinance institutions, and reduce the propensity of subsidized donor funding.

References:

- Ahmad, Q. K., Eds. (2007). Socio-Economic and Indebtedness-Related Impact of Microcredit in Bangladesh. UPL Publications. Dhaka.
- Ahsan, M. (2010). Microinsurance, Poverty and Vulnerability: A Concept Paper. InM Working Paper No. 1. Dhaka: Institute of Microfinance (InM)
- Alamgir, Dewan H. (2010). State of Microfinance in Bangladesh. Dhaka: Institute of Microfinance (InM). URL: http://www.inm.org.bd/publication/state_of_micro/Bangladesh.pdf
- Ashta, Arvind; Saleh Khan and Philipp Otto. (2011). “Does Microfinance Cause or Reduce Suicides? Policy Recommendation for Reducing Borrower Stress” Microfinance Gateway. Available at: <http://www.microfinancegateway.org/gm/document-1.9.49964/Does%20Microfinance%20Cause.pdf> (retrived April 9, 2012)
- Charitonenko, S., & Rahman, S. M. (2002). Bangladesh: Commercialization of Microfinance. Manilla: Asian Development Bank (ADB).
- Faruquee, R. (2011). InM Policy Note: Are Interest Rates Charged by MFIs Too High? (Draft)
- Faruquee, R., & Badruddoza, S. (2011). InM Occasional Paper. Microfinance in Bangladesh: Past, Present and Future . Dhaka: Institute of Microfinance (InM).
- Hashemi, Syed. 1997. Those Left Behind: A Note on Targeting the Hardcore Poor, chapter 11 in Geoffrey Wood and Iffath Sharif, eds., Who Needs Credit? Poverty and Finance in Bangladesh. Dhaka: University Press Limited.
- Hossain, M. (2002). Credit for Alleviation of Rural Poverty: The Experience of Grameen bank in Bangladesh. In A. Rahman, R. I. Rahman, M. Hossain, & S. M. Hossain(eds.), Early Impact of Grameen: A Multi-Dimensional Analysis: Outcome of a BIDS Research Study. Dhaka: Grameen Trust.
- Hossain, Mahbub. 2002. Credit for Alleviation of Rural Poverty: The Experience of Grameen Bank in Bangladesh”, in A. Rahman, R. I. Rahman, M. Hossain and S. M. Hossain (eds.) Early Impact of Grameen: A Multi-Dimensional Analysis: Outcome of a BIDS Research Study. Grameen Trust, Dhaka.
- InM & CDF. (2007-2009). Bangladesh Microfinance Statistics. Dhaka: Institute of Microfinance, Credit & Development Forum.
- Iqbal, Kazi. (2011). Strategic Behavior of NGO-MFIs. Dhaka: Institute of Microfinance (InM).
- Karlan, Dean and Sendhil Mullainathan. (2009). Is Microfinance Too Rigid? VoxEU, December 2007
- Khalily, M. A. Baqui.; Faridi, Rushad. (2011) Multiple Memberships (Overlapping) in Micro Credit Markets of Bangladesh. Dhaka: Institute of Microfinance (InM).
- Khalily, M. A. Baqui.; Khaleque, M. Abdul; Bidisha, Sayema Haque; and Ahmed, Mehrun. (2012) Access to Financial Services in Bangladesh. Dhaka: Institute of Microfinance (InM).

- Khalily, M. A. Baqui; M. A. Latif; A. Rabbani; K. Iqbal; M. Ahmed; M. M. Hasan; M. A. Khaleque; M. M. Hasan; P. K. Roy; J. Sayeed. 2010b. Impact of Prime Program for Monga Mitigation: An Analysis of Panel and Cross Sectional Data (PRIME-II). Dhaka: Institute of Microfinance.
- Khalily, M. A. Baqui; M. A. Latif; M. M. Hasan; M. A. Khaleque; B. N. Ahmed; R. Hashmi; M. N. U. Sarwar; M. T. F. Khan. 2010a. Impact of Prime Interventions on Monga Mitigation in Greater Rangpur Region in Bangladesh (PRIME-I). Dhaka: Institute of Microfinance.
- Khandker, Shahidur R. & S. Badruddoza. (2012). "Growth and Performance of MFIs in Bangladesh". Institute of Microfinance (InM), Dhaka. (forthcoming)
- Khandker, Shahidur R. 1998. Fighting Poverty with Microcredit: Experience in Bangladesh. Oxford University Press, Inc. New York.
- Khandker, Shahidur R. 2000. Savings, Informal Borrowing and Microfinance. The Bangladesh Development Studies, Vol. XXVI Nos. 2 & 3, June-Sept, Special issue on Microfinance and Development: Emerging Issues. Dhaka.
- Khandker, Shahidur R. and Wahiduddin Mahmud. 2010. Seasonal Hunger and Public Policies: Evidence from Northwest Bangladesh, Book Manuscript, Dhaka: Institute of Microfinance.
- Khandker, Shahidur R.; M. A. Baqui Khalily; and Hussain A. Samad. 2010. Vulnerability to Seasonal Hunger and Its Mitigation in Northwest Bangladesh. InM Working Paper No. 4, Institute of Microfinance (InM), Dhaka.
- Matin, I. et. al. 2002. Finance for the Poor: from Microcredit to Microfinance Services, Journal of International Development, Vol. 14.
- Melik, J. (2010, November 3). Microcredit "death trap" for Bangladesh's poor. BBC Business Daily .
- Morduch J. 1998. Does Microfinance Really Help the Poor? Evidence from Flagship Programs in Bangladesh, Harvard University, mimeo.
- Pitt, M. M. and S. R. Khandker. 1998. The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter?" Journal of Political Economy, October, Vol. 106. No. 5, pp. 958-996.
- Pitt, M. M. and S. R. Khandker. 2002. Credit Programs for the Poor and Seasonality in Rural Bangladesh. The Journal of Development Studies, Taylor and Francis Journals, Vol. 39(2), pages 1-24, January.
- Rabbani, A., Hasan, M. M., Hasan, M., Mithun, T. C., & Howlader, A. (2011). Effectiveness of PRIME Interventions in Greater Rangpur at the Household level and Institutional level:A Longitudinal Approach. Dhaka: Institute of Microfinance (InM).
- Rahman, H.Z., Hossain, M. 1991. The Anatomy of Mora Kartik: an Enquiry into the Economic Health of the Countryside. Technical Report. Bangladesh Institute of Development Studies.

- Roodman, David & Jonathan Morduch, 2009. "The Impact of Microcredit on the Poor in Bangladesh: Revisiting the Evidence." in CGD Working Paper . Washington, D.C.: Center for Global Development.
- Roodman, David. (November 21, 2011). "Microcredit Story out of Bangladesh". David Roodman's Microfinance Open Book Blog. Available at: http://blogs.cgdev.org/open_book/2011/11/microcredit-suicide-story-out-of-bangladesh.php (retrieved April 9, 2012)
- Schuler, S. R.; S. M. Hashemi and A. P. Riley. 1997. The influence of women's changing roles and status in Bangladesh's Fertility Transition: Evidence from a Study of Credit Programs and Contraceptive Use. *World Development*, 25(4), 563-575.
- Sharif, I. 2001. Microfinance and Growth: Is There a Link?, pp.47-59, in Sharif, I. and G. Wood (eds.) *Challenges for Second Generation Microfinance: Regulation, Supervision and Resource Mobilization*. The University Press Ltd., Dhaka.
- Shonchoy, Abu. 2008. Seasonal Migration and the Effectiveness of Micro-credit in the Lean period: Evidence from Bangladesh. The University of New South Wales, November 24, 2008: pp. 6.
- Sinha, S. (2011). *Bangladesh Microfinance Review*. Dhaka: BRAC Development Institute.
- Zaman, H., (1999). *Assessing the Poverty and Vulnerability Impact of Microcredit in Bangladesh: A Case Study of BRAC*. Policy Research Working Paper No. 2145, Washington DC: The World Bank.